April 07, 2020

Thirumalai Chemicals Limited: Ratings reaffirmed; outlook revised to Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term; Term Loans	200.00	200.00	[ICRA]A+; reaffirmed, outlook revised to Negative from Stable
Long Term; Fund-based Facilities	208.20	208.20	[ICRA]A+; reaffirmed, outlook revised to Negative from Stable
Short Term; Non-fund Based Facilities	407.40	407.40	[ICRA]A1+; reaffirmed
Long Term/Short Term; Unallocated	9.40	9.40	[ICRA]A+/A1+; reaffirmed, outlook revised to Negative from Stable
Total	**825.00**	**825.00**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings reaffirmation continue to favourably consider established track record and market position oh Thirumalai Chemicals Limited (TCL) in the PAN segment in India and its moderate working capital intensity of operations. Further, ICRA takes note of the diversification benefits provided by the sale of downstream derivative products such as esters and food acids and the sale of maleic anhydride under the Malaysian subsidiary. ICRA also takes note of the ongoing capacity expansion programme, under which TCL has modernised its facilities at Ranipet and is currently in the process of setting up of a greenfield PAN plant in Dahej, Gujarat. While the Ranipet project was completed in FY2020 and the operations have stabilised, the Dahej project is expected to be completed in early FY2021 though there may be some delays on account of Covid-19 related issues. The domestic projects have been partly debt funded and the company may draw down additional loans for the completion of the Dahej project. The company is also planning to set up a food acid plant in USA under a subsidiary, for which it will incur large debt-funded (to be availed at the subsidiary level) capex with equity contribution by TCL India. TCL's capital structure and coverage indicators, which had witnessed a healthy improvement during FY2016-FY2018, witnessed a moderation in subsequent periods although they remain comfortable. However, with the large capex plan, the capital structure and coverage indicators (consolidated) will witness a moderation in the near to medium, unless there is a sustained recovery in the product-raw material price spreads. Any additional debt-funded capex (at the consolidated level) remains a rating sensitivity factor.

The revision in the outlook for the long-term rating of TCL to Negative considers the significant weakening in the financial performance in 9M FY2020, resulting in a decline in revenue and moderation in the profit margin of the consolidated entity. This was mainly due to a steep contraction in the phthalic anhydride (PAN)–orthoxylene (OX) spreads due to the global demand slowdown and the subdued performance of the Malaysian subsidiary. Further, due to the impact of the Covid-19 outbreak and the containment measures undertaken by the Government, the performance may be affected in FY2021 as well. The extent of the potential impact remains uncertain at present, given the evolving nature of the issue, and will be monitored. Any recovery in performance will depend on a recovery in demand in the domestic markets and an improvement in the product-raw material spreads, which, in turn, will depend on an improvement in the global demand.

The ratings remain constrained by the susceptibility of the financial performance to the volatility in PAN-OX spreads, which are dependent on crude price levels, cyclicality in demand from the end-user industries and competition from imports. Further, the domestic industry remains vulnerable to changes in the duty structure as witnessed in the recent past when the revocation of the anti-dumping duty (ADD) led to increased pricing pressure from imports. Nonetheless, ICRA notes that TCL's ability to withstand the above-mentioned risks is better, compared to earlier downturns, due to several cost control initiatives taken by the company in the last few years.

Key rating drivers and their description

Credit strengths

Established operating track record and market position in PAN industry – TCL is the second largest player with a significant market share in the domestic PAN industry, which is a duopoly. The company's three decades of experience resulted in established relationships with clients in key end-user industries such as plasticizers, CPC, paints, and UPR. TCL also has a long-standing relationship with Reliance Industries Limited, the supplier of the raw material, OX, and operates on an assured offtake model.

Healthy capitalisation and coverage metrics despite sharp fall in margins – Due to unfavourable changes in the demand-supply scenario in the global market, the PAN-OX spreads have declined substantially. This led to a moderation in TCL's operating profits to 16.4% in FY2019 and 8.3% in 9M FY2019, at the consolidated level, from a high of 22.6% in FY2018. Margins at the Malaysian subsidiary, Optimistic Organic Sdn. Bhd. (OOSB), also remained weak due to the increase in raw material prices. However, despite the weakening of margins and increase in debt levels, the capitalisation and coverage indicators remained healthy. At the consolidated level, the debt level increased to ~Rs. 180 crore as on September 30, 2019, leading to some deterioration in the capital structure, with a gearing of 0.3 times as on September 30, 2019 against 0.15 times as on March 31, 2019 (PY: 0.09 times). TOL/TNW also stood at 0.7 times as on September 30, 2019 (0.7 times as on March 31, 2019). The other coverage indicators such as interest cover and TD/OPBDITA also witnessed moderation but remained healthy at 7.6 times and 1.7 times, respectively, as on September 30, 2019 compared to 17.0 times and 0.5 times, respectively, as on March 31, 2019. The company's working capital intensity also remained modest at 6% in 6M FY2020 compared to 4% in FY2019 on the back of a balanced working capital cycle. Additionally, the debt of the Malaysian subsidiary is expected to be serviced from its own cash flows. However, in the absence of a recovery in the profit margins and given the large capex plans (consolidated), the financial profile risk profile will witness pressure in the near to medium term.

Diversification into other related chemicals – The company produces phthalate esters and food acids, which are downstream derivatives. The contribution of these products has grown over the years, given the improving demand in the market. Maleic anhydride (MAN) operations at OOSB had also turned around in the past few years, driven by an increase in capacity utilisation and product realisations. However, in FY2019 and 9M FY2020, OOSB's performance was subdued due to the impact of unplanned shutdowns and increase in raw material prices.

Expansion/modernisation of capacity of various product lines – The company has undertaken a large capital expenditure programme to modernise the Ranipet PAN plant, enhance the derivatives capacity, and set up a greenfield PAN/derivatives project in Dahej. While the Ranipet project was completed and stabilised in FY2020, the Dahej project is expected to be completed in FY2021. These initiatives would help TCL maintain its market position and improve its competitiveness, given that the greenfield project is located near the supplier, the majority of the existing customers and a potentially large export market, the Middle East.

Credit challenges

Presence in commodity chemical industry and competition from imports limit pricing flexibility – Limited product differentiation and large volumes of inter-regional trade of PAN have resulted in TCL's realisations being influenced by the overall demand-supply dynamics in the region. The key end-user industries of the product are plasticizers, paints and pigments, which are mainly used in the construction and automobile sectors. Hence, the demand is based on broader economic conditions. With regard to supply, the market dynamics change significantly based on the production and consumption in key markets such as China, Korea and South East Asia. Even though TCL has long-to medium-term contracts with a large number of its customers, the product realisations are volatile.

Imports of PAN into India increased to 1,44,801 MT in FY2019 (PY: 1,30,440)[1] from 52,350 MT in FY2015, mainly driven by the increase in consumption, which is higher than the production of the domestic industry. In addition, the revocation of the ADD imposed in 2012 on producers from countries such as Korea and Taiwan in H2 FY2019 led to higher imports in 9M FY2020, which stood at 1,34,749 MT. With the domestic demand being higher than the domestic capacity, the offtake risk for producers like TCL is low. However, their performance remains susceptible to changes in Government policies and regulation regarding international trade and trade protection metrics. Hence, the business remains susceptible to significant regulatory changes.

Raw material price volatility impacts product demand and margins – The price of OX has remained highly volatile in the past, depending on crude price as well as demand trends for other products from the xylene stream. The company's product demand and its working capital intensity are impacted during periods of high OX prices. TCL has, however, rationalised its production lead time and inventory management in recent years, strengthening its ability to pass on OX price changes to its customers. While the fall in crude oil prices is expected to result in a moderation in raw material prices for the company, any improvement in the product-raw material price spread will also depend on the pickup in demand in the region, which has been impacted by the Covid-19 outbreak and the containment measures undertaken by the Government.

Large debt-funded capex plans and project execution risks – The ongoing capex at Dahej is nearing completion and was expected to commence operations in Q1 FY2021 although there may be some delay on account of Covid-19 related issues. However, the early stabilisation of operations post completion will be crucial to achieve growth. The Ranipet and Dahej projects were earlier planned to be funded by internal accruals. However, TCL subsequently availed ~Rs. 200-crore loans (a part of which was for the reimbursement of the capex already incurred), of which

[1] *Source: DGFT*

~Rs. 140 crore has been availed till date. TCL is also in the process of undertaking a large capex under a subsidiary in the US for manufacturing food acids, which will be partly debt funded (availed by the subsidiary but guaranteed by TCL). This will expose the consolidated entity to project execution risks and put pressure on the consolidated capital structure and coverage indicators, over the near to medium term, unless there is a meaningful recovery in the profit margin. Moreover, any additional large debt-funded capex will put further stress on the credit profile.

Liquidity position: Adequate

The company had a positive fund flow from operations in the last few years and the free cash flows also remained positive in FY2019 despite the high capex. In FY2020, despite a moderation in the profit margin, the fund flow from operations is expected to be positive. Further, due to the impact of the Covid-19 related shutdown, there will be some adverse impact on cash flows in FY2021. However, the liquidity position remains adequate to meet the capex requirements and repayment obligation of ~Rs. 20-21 crore in FY2021, supported by unencumbered cash balance and liquid investments, undrawn term loans for the project and unutilised working capital limits.

Rating sensitivities

Positive trigger – ICRA could revise the outlook if there is a sustained improvement in the revenue and profitability, supported by the timely completion and stabilisation of the ongoing capacity expansion projects, while maintaining a healthy capital structure, coverage indicators and working capital intensity.

Negative trigger – Pressure on the ratings could emerge if there is a sustained decline in the revenue and profitability or a stretch in the working capital cycle, which along with the planned debt-funded capex, results in the weakening of the credit profile. The ratings may be downgraded if TD/OPBDITA exceeds 2.5 times. Any large adverse impact on account of the Covid-19 measures also remains a sensitivity factor.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Chemical Industry
Parent/Group Support	Parent/Group Company: NA
Consolidation/Standalone	The ratings are based on the consolidated financial statements of the rated entity.

About the company

TCL started its operations in 1976 at Ranipet in Tamil Nadu as a single product petrochemical company manufacturing phthalic anhydride, with a production capacity of 6,000 TPA. The company is a part of the Thirumalai Group, which has business interests in chemicals, surfactants, pigments and education. Over the years, TCL has expanded its PAN manufacturing capacity to ~1,45,000 TPA and has added other products to its portfolio, which includes food additives such as maleic acid and fumaric acid, PAN derivatives such as di-ethyl phthalate (DEP) and phthalimide (PID). TCL caters to customers in the construction, auto, paint, food, personal care and pharma industries. The company has developed a low energy process, which enables it to meet ~90% of its power requirements through waste heat recovery. It also has a maleic anhydride manufacturing facility in Malaysia, under its step-down subsidiary, Optimistic Organic Sdn. Bhd. (OOSB).

In 9M FY2020, on a provisional basis, TCL reported a net profit of Rs. 20.7 crore on an operating income of Rs. 803.4 crore at the consolidated level compared to a net profit of Rs. 95.8 crore on an operating income of Rs. 945.3 crore in 9M FY2019.

Key financial indicators (audited; consolidated)

	FY2018	FY2019	6M FY2020
Operating Income (Rs. crore)	1,312.0	1,261.0	558.7
PAT (Rs. crore)	170.4	113.6	22.0
OPBDIT/OI (%)	22.6%	16.4%	9.3%
RoCE (%)	48.2%	28.2%	11.0%
Total Outside Liabilities/Tangible Net Worth (times)	0.4	0.7	0.7
Total Debt/OPBDIT (times)	0.2	0.5	1.7
Interest Coverage (times)	23.1	17.0	7.6
DSCR			

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding	Rating	FY2020	FY2019	FY2018
					7-04-2020	17-May--2019	03-Oct-2018	-
1	Term loans^	Long Term	200.0	140.0	[ICRA]A+ (Negative)	[ICRA]A+(Stable)	-	-
2	Fund-based facilities	Long Term	208.2*		[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	-
3	Non-fund based facilities	Short Term	407.4*		[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-
4	Unallocated	Long Term /Short Term	9.4		[ICRA]A+ (Negative)/[ICRA]A1+	[ICRA]A+ (Stable) / [ICRA]A1+	[ICRA]A+ (Stable) / [ICRA]A1+	-

*Amount in Rs. crore; * Partial interchangeability between fund-based and non-fund based facilities*

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan 1 – IDFC First Bank Limited	31-Jul-19	10.15%	31-Jul-26	100.0	[ICRA]A+(Negative)
NA	Term Loan 2 – Axis Bank Limited	03-Aug-19	9.00%	03-Aug-25	100.0	[ICRA]A+(Negative)
NA	Cash Credit	-	-	-	208.2	[ICRA]A+ (Negative)
NA	Non-fund based facilities (LC/BG)	-	-	-	407.4	[ICRA]A1+
NA	Unallocated	-	-	-	9.4	[ICRA]A+ (Negative)/ [ICRA]A1+

Source: TCL

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Cheminvest Pte. Ltd.	100.00%	Full Consolidation
Optimistic Organic Sdn Bhd.	100.00%	Full Consolidation
Lapiz Europe Ltd	100.00%	Full Consolidation
TCL Global B V*	100.00%	Full Consolidation

**financials of TCL Global B V have been included at consolidated financial statement since Q2 FY2020*

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About ICRA Limited:

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